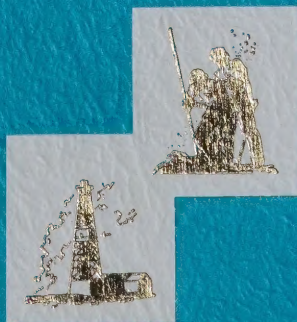


*L*ayrock
*L*esources
LIMITED

ANNUAL REPORT

1978



RAYROCK RESOURCES LIMITED

DIRECTORS

J. C. BYRNE, Toronto
President and Managing Director, Discovery Mines Limited

D. R. CROMBIE, Toronto
Vice-President, Discovery Mines Limited

H. EARL JOUDRIE, Calgary
President and Chief Executive Officer, Voyager Petroleums Ltd.

JOHN KOSTUIK, Toronto
Director and Consultant, Denison Mines Limited

J. J. RANKIN, Toronto
President and Managing Director, Pominex Limited

G. T. SMITH, Toronto
President and Chief Executive Officer, Northgate Explorations Limited

H. J. WHELAN, Toronto
President, The Lummus Company Canada Limited

OFFICERS

J. C. BYRNE
Chairman of the Board and Chief Executive Officer

D. R. CROMBIE
President and Operations Manager

W. STEUERMAN
Secretary-Treasurer

SENIOR GEOLOGIST

T. ANTONIUK

EXECUTIVE OFFICE

Suite 1011, 2200 Yonge Street, Toronto, Canada

TRANSFER AGENTS AND REGISTRARS

CROWN TRUST COMPANY, Toronto

BANKERS

ROYAL BANK OF CANADA, Bay and Temperance Branch, Toronto

AUDITORS

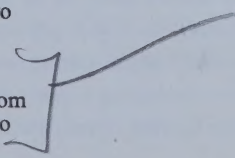
COOPERS & LYBRAND, Toronto

SOLICITORS

CAMPBELL, GODFREY & LEWTAS, Toronto

ANNUAL MEETING

May 29, 1979, 11:00 a.m., Westminster Room
Westbury Hotel, 475 Yonge Street, Toronto



Directors' Report to the Shareholders:

The Company's oil and gas division which is currently the principal source of revenue registered a substantial increase in natural gas reserves during 1978. Estimated gas reserves were in excess of five billion cubic feet at year end and recoverable oil reserves were 840,000 barrels. A new copper-zinc-silver discovery plus improved base and precious metal prices have significantly increased the value of Rayrock's mining interests.

Your Company's expenditures on hydrocarbon exploration amounted to \$677,000 in 1978. Participation in the drilling of 55 exploratory wells resulted in 31 gas wells, 1 oil well, and 23 dry holes for a 60% success ratio. Forty-seven of the wells were drilled in Alberta, 5 in northeast British Columbia, and 3 in northeast Montana. Rayrock and its associates plan to maintain and possibly increase their participation in programs in British Columbia and Alberta. The Montana project has been terminated.

Rapidly increasing land prices and exploration costs, combined with large volumes of shut-in gas are a problem for the industry in Western Canada. To sustain the current level of exploration and development, it will be necessary for the price of oil and gas to continue to move upwards.

Rayrock now owns 25.3% of the issued shares of Pyx Explorations Ltd., and effectively controls that company. Pyx in turn controls a 25% net profits interest in the Norita Mine in northwest Quebec, where a new copper-zinc-silver orebody has been discovered. At present mining costs and metal prices, the revenue accruing to Pyx over the next eight years should be significant. Pyx has taken a participation in oil and gas exploration in Western Canada and it is planned to increase Pyx's activity in that field.

The Pinson gold deposit in Nevada, which has been extensively reviewed in previous reports, now appears to be economically viable. The change of status for this project has been brought about by the increased gold price, and by a revised engineering approach to the project that has resulted in some reduction in capital cost, as measured in constant dollars. During 1979 it is expected that a formal production decision will be made to develop an open pit mine and construct a 1000 ton per day gold mill. Rayrock has a 20% interest in this project.

The Cordex Syndicate (Rayrock 22% interest) has discovered a uranium deposit near the Nevada-Oregon boundary which may be of economic importance. Drilling to date has indicated several million tons averaging 1 lb. U_3O_8 per ton, with some evidence that part of the deposit may be of higher grade. This discovery adjoins an extensive deposit being explored by Placer Development. Rayrock's total expenditure on mining exploration in 1978 was \$443,074, most of which was spent on the Cordex projects and the Iberian Syndicate which is exploring for silver-lead deposits in Spain.

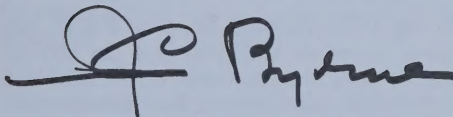
Cash flow from operations in 1978 before deducting exploration expenditures amounted to \$946,190. Working capital at year end was \$1,566,000, and the market value of investments totalled

RAYROCK RESOURCES LIMITED

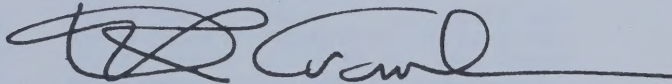
\$2,738,000. The Company's policy is to reinvest substantially all of its cash flow in resource exploration and development; consequently reported net earnings are modest.

At the forthcoming annual meeting, shareholders will be asked to approve an increase in the Company's authorized common share capital, and to approve the creation of a class of preferred shares. The proposed increases in capital are to provide the Company with flexibility in financing if suitable investment opportunities become available in the future. Subsequent to the year end, Ashland Oil Canada Limited sold its block of 930,000 shares of Rayrock Resources Limited. Discovery Mines Limited, 49% owned by Rayrock, purchased 390,000 shares and that company now holds 29.7% of Rayrock's outstanding shares. The balance of the block was distributed to other companies.

On behalf of the Board,

A handwritten signature in dark ink, appearing to read "J. P. Pyne", written over a horizontal line.

Chairman and Chief Executive Officer

A handwritten signature in dark ink, appearing to read "D. C. Crawl", written over a horizontal line.

President and Operations Manager

Toronto, Ontario
April 11, 1979

RAYROCK RESOURCES LIMITED

OIL AND GAS

RODNEY AREA AND GOBLES FIELDS

Rayrock operates three wholly-owned waterflood oilfields in southwest Ontario. Although production is declining, rising oil prices and careful cost control have resulted in a modest increase in net revenue in 1978 compared with 1977.

An independent consultant has estimated that, as at January 1, 1979, remaining recoverable reserves amount to 840,000 barrels.

The table below gives the significant operating information for 1977 and 1978.

	1978	1977	% Change
Sales (BBLs)	111,362	125,429	- 11.2
Sales (gross)	\$1,432,453	\$1,357,452	+ 5.5
Royalties and transportation	\$239,675	\$230,806	+ 3.9
Production expenses	\$390,400	\$372,418	+ 4.8
Net field revenue	\$802,378	\$754,228	+ 6.4

CANADIAN OIL & GAS FUND (1975) JOINT VENTURE

Rayrock owns a 28.5% net interest in this joint venture. Most of the production and reserves are in the shallow gas areas of southeast Alberta. Effective August 1, 1978, the Alberta Government introduced a new royalty schedule for gas wells that is particularly beneficial for the shallow gas producers. The result is that economically recoverable reserves are increased as is the cash flow.

Net cash flow for Rayrock amounted to some \$82,000 in 1978.

SIGNALTA JOINT VENTURE

Rayrock finances direct participations in gas exploration and development with Signalta Resources Ltd. of Calgary. To the end of 1978, Rayrock has participated in a total of 22 wells in east central Alberta. Rayrock's net interest before payout is from 15% to 12.5%, and after

payout from 12.5% to 5.3%. Twelve of the 22 wells were completed as potential gas producers. Although some of the gas will remain shut in for an indeterminate period, by 1980 it is expected that net cash flow will be \$100,000 to \$150,000 per annum. Rayrock will also be participating in the construction of a gas processing plant.

Rayrock's share of proven plus probable reserves is estimated to be 2.7 BCF.

RENAISSANCE JOINT VENTURE

During 1978, Rayrock financed a 6.7% net interest at a cost of \$225,000 in a gas and oil exploration program managed by Renaissance Resources Ltd. of Calgary. Renaissance participated in drilling 36 wells, which resulted in 22 gas wells, 1 oil well and 13 dry holes. The drilling, for the most part, was in southern Alberta, although several wells were drilled in northeast British Columbia and northern Alberta. Rayrock's share of reserves (before royalties) amounts to approximately 0.7 BCF gas plus liquids equivalent. Two wells will be on stream in early 1979, and possibly 2 additional wells will come on stream toward the end of 1979.

Rayrock has agreed to finance a 5.7% net interest in the 1979 program at a cost of \$250,000.

UNITED STATES

The northeast Montana project, described in last year's annual report, was an oil exploration play. The drilling program was terminated after three wells were drilled. Rayrock retains a 5% interest in approximately 16,000 acres of leases that cover a number of prospects.

Rayrock is paying 5% of the cost of two wildcat wells to be drilled under a farm-in agreement in the Palo Duro Basin in Texas. One well has been drilled and abandoned.

RAYROCK RESOURCES LIMITED

MINING

NORITA QUEBEC MINES LIMITED

The Norita mine, located in the Matagami district, is a copper-zinc-silver producer that has been shipping approximately 900 tons of ore per day since 1976. The mine has been operated by Orchan Mines Limited, with the ore milled in the Orchan concentrator. To the end of 1978, a total of 813,116 tons averaging 6.1% zinc and 0.50% copper were milled. In 1978, the A Zone, an orebody with a much higher copper content, was discovered. Drill indicated A Zone reserves to date are approximately 2,500,000 tons with an average grade of 2.80% copper and 4.0% zinc. Development of the A Zone was underway at year end.

The mine is now operated by a division of Noranda Mines Limited, and Noranda reports that, at year end, the total proven plus drill indicated reserves in the Norita mine amount to 3,434,000 tons averaging 4.56% zinc, 1.83% copper, and 0.79 oz. silver per ton. At the planned mining rate of 400,000 tons per year there is an 8-year ore supply, and there are indications that additional reserves can be anticipated.

Norita Quebec has a 25% net profits interest in the Norita mine plus a 25¢ per ton royalty on the first 2 million tons. Rayrock effectively controls Norita Quebec through a 27.5% combined direct and indirect equity interest.

PINSON PROJECT

An update of the feasibility study of Pinson, completed in January 1979, showed that at \$225 US per ounce for gold the project is economically viable. Subject to the results of final engineering data now being compiled, it is expected that a formal production decision will be made for the project by mid-1979. Located in northern Nevada, Pinson is a gold deposit which is mineable by open pit. The most recent ore reserve estimate totalled 1,400,000 tons averaging 0.18 oz./ton gold in the main deposit, plus some 3,000,000 tons averaging 0.079 oz./ton gold in other zones in the area.

The capital cost to develop a mine and construct a 1000 TPD mill is estimated to be 11 to 12 million dollars. About 75% of the cost can be financed by bank project loans.

Rayrock has a 20% interest in the Pinson project.

CORDEX SYNDICATE

Drilling on Cordex's McDermitt Basin uranium prospect has indicated a flat lying deposit with an average thickness of about 18 feet, lying at a depth of approximately 600 feet. At least 5 million tons averaging 1.0 lb. U_3O_8 per ton are indicated, and drilling now underway suggests that the western part of the zone has a better grade and thickness. The Cordex property adjoins the claim group being drilled by Placer Development, on which they have reported 13 million tons averaging 1.0 lb. U_3O_8 per ton.

Other Cordex Syndicate projects during 1978-79 include exploration programs on a copper-gold prospect in western Arizona, and on a disseminated gold occurrence in the same general area.

The Cordex Syndicate is financed by Dome Mines, Lacana Mining Corporation, McIntyre Mines, and Rayrock. Each company has a 22% interest.

GENERAL EXPLORATION

The Iberian Syndicate, exploring a silver-lead-zinc district in southern Spain, continued with geological studies and geochemical surveys. The concession areas controlled by the Syndicate are well mineralized, and many drilling targets are being identified.

In Wisconsin, drilling on Rayrock's 60% owned mineral rights did not reveal commercial values. The mineral rights will be retained.

The Rayrock-Ryowa uranium exploration program in the Northwest Territories completed the 1978 field season without locating anything of economic interest, and the program has been terminated.

RAYROCK RESOURCES LIMITED

Consolidated Balance Sheet

ASSETS

	1978 \$	1977 \$
Current assets		
Cash	216,367	103,655
Short-term deposits	1,250,000	1,250,000
Accounts receivable and prepaid expenses	235,441	202,014
Income taxes recoverable	19,000	28,354
Unexpended exploration advances	—	143,000
	<u>1,720,808</u>	<u>1,727,023</u>
Investments and advances (notes 1(f) and 2)	<u>2,613,282</u>	<u>2,683,224</u>
Oil and gas properties (note 1(e))		
Petroleum and natural gas leases — at cost, less accumulated depletion (1978 — \$1,174,094; 1977 — \$1,012,036)	1,947,543	1,849,940
Well equipment — at cost, less accumulated depreciation (1978 — \$195,379; 1977 — \$189,196)	28,889	26,783
Interest in Ranchmen 1977 Partnership	49,585	20,000
	<u>2,026,017</u>	<u>1,896,723</u>
Mining properties		
Mining claims — at cost	—	25,002
Interest in net assets of the Icon Sullivan Joint Venture — at estimated realizable value	50,334	53,766
Mine buildings and equipment — at cost, less accumulated depreciation (1978 — \$49,247; 1977 — \$38,609) (note 1(e))	86,299	111,794
	<u>136,633</u>	<u>190,562</u>
Other assets		
Head office furniture — at cost, less accumulated depreciation (1978 — \$20,893; 1977 — \$19,495) (note 1(e))	5,502	5,833
Leasehold rights — at cost, less accumulated amortization (1978 — \$9,252; 1977 — \$4,626)	6,168	10,794
	<u>11,670</u>	<u>16,627</u>
	<u><u>6,508,410</u></u>	<u><u>6,514,159</u></u>

as at December 31, 1978

LIABILITIES

Current liabilities

Bank indebtedness (note 3)	21,028	84,468
Accounts payable and accrued liabilities	134,207	77,730
Promissory notes payable	—	143,000

1978
\$

1977
\$

Deferred income taxes (note 1(c))

155,235

305,198

627,000

549,000

782,235

854,198

SHAREHOLDERS' EQUITY

Capital stock (note 4)

Authorized —

5,000,000 shares of no par value

Issued and fully paid —

4,510,000 shares

4,506,200

4,460,000

Contributed surplus (note 4)

636,212

621,456

Retained earnings

637,457

634,642

5,779,869

5,716,098

Purchase of capital stock (note 4)

53,694

56,137

5,726,175

5,659,961

SIGNED ON BEHALF OF THE BOARD

J. C. BYRNE, Director

H. J. WHELAN, Director

6,508,410

6,514,159

RAYROCK RESOURCES LIMITED

Consolidated Statement of Earnings and Retained Earnings

For the Year Ended December 31, 1978

	1978 \$	1977 \$
Revenue		
Revenue from petroleum operations	1,758,612	1,643,655
Investment income	261,654	162,246
	<u>2,020,266</u>	<u>1,805,901</u>
Expenses		
Cost of petroleum production	870,925	812,906
Administrative and general	152,068	175,765
Depreciation, amortization and depletion	230,571	256,120
Mining claims written off	25,002	—
	<u>1,278,566</u>	<u>1,244,791</u>
Earnings before the undernoted items	<u>741,700</u>	<u>561,110</u>
Exploration expenditures (note 1(d))	<u>443,074</u>	<u>293,445</u>
	<u>298,626</u>	<u>267,665</u>
Provision for (recovery of) income taxes (note 1(c))		
Current	(19,612)	(12,474)
Deferred	78,000	90,000
	<u>58,388</u>	<u>77,526</u>
	<u>240,238</u>	<u>190,139</u>
Share of gain (loss) determined by the equity method	7,317	(3,354)
Oil interest (north-east Montana project) written off	<u>(169,558)</u>	<u>—</u>
Earnings before extraordinary items	<u>77,997</u>	<u>186,785</u>
Extraordinary items (note 5)	<u>(75,182)</u>	<u>(12,906)</u>
Net earnings for the year	<u>2,815</u>	<u>173,879</u>
Retained earnings — beginning of year		
As previously reported	735,695	470,351
Adjustment of prior years' investment income (note 6)	101,053	9,588
As restated	634,642	460,763
Retained earnings — end of year	<u>637,457</u>	<u>634,642</u>
Earnings per share before extraordinary items	<u>\$0.02</u>	<u>\$0.04</u>
Earnings per share for the year	<u>\$0.00</u>	<u>\$0.04</u>

RAYROCK RESOURCES LIMITED

Consolidated Statement of Changes in Financial Position

For the Year Ended December 31, 1978

	1978 \$	1977 \$
Source of working capital		
Current operations —		
Earnings for the year before extraordinary items	77,997	186,785
Items which did not require the use of working capital —		
Deferred income taxes	78,000	90,000
Share of (gain) loss on equity method	(7,317)	3,354
Depreciation, amortization and depletion	230,571	256,120
Gain on sale of investments	(82,026)	(66,683)
Loss on sale of mine equipment	—	24,776
Mining claims written off	25,002	—
Oil interests written off	193,767	—
Gain on sale of oil interests	(17,726)	—
	<u>498,268</u>	<u>494,352</u>
Proceeds on sale of investments	569,364	369,664
Proceeds on sale of equipment	4,249	46,583
Share of proceeds on sale of Icon Sullivan assets	—	11,876
Proceeds on sale of capital stock	95,463	12,176
Proceeds on sale of oil interests	345,706	—
Dividends applied to reduce cost of investment	—	91,465
Other	—	1,030
	<u>1,513,050</u>	<u>1,027,146</u>
Use of working capital		
Purchase of equipment	10,959	912
Additions to oil and gas properties	676,689	433,251
Purchase of capital stock	32,064	9,810
Investments and advances	635,990	127,094
Advances to officers and employees — net	13,600	2,800
	<u>1,369,302</u>	<u>573,867</u>
Increase in working capital	143,748	453,279
Working capital — beginning of year	1,421,825	968,546
Working capital — end of year	1,565,573	1,421,825

RAYROCK RESOURCES LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Year Ended December 31, 1978

1. Accounting policies

The accounting policies of the company are in accordance with generally accepted accounting principles and the significant policies are outlined below:

(a) Basis of consolidation

The consolidated financial statements include the accounts of the company and its subsidiary, Rayrock Mines, Inc.

(b) Translation of accounts of foreign subsidiary company

The accounts of the wholly-owned U.S. subsidiary are translated into Canadian dollars at the following rates:

Current assets and liabilities at December 31 exchange rates;

All other assets and liabilities at the exchange rates prevailing when the assets were acquired or the liabilities assumed.

(c) Income taxes

The company follows the tax allocation method of accounting whereby the provision for income taxes is based upon income reported in the accounts.

(d) Exploration expenditures

Costs incurred in exploring for minerals are charged to expense in the year incurred.

Costs incurred in exploring for oil and gas, including participations in joint ventures, are capitalized until completion of the particular exploration programme, at which time the costs of dry holes are written off. Acquisition costs of oil and gas properties and the costs of drilling and equipping successful wells are capitalized.

(e) Depreciation and depletion

Depreciation is provided on a declining balance basis at rates sufficient to amortize the cost of these assets over their estimated useful lives. The rates in use are as follows:

Head office furniture	20%
Oil well equipment	4% - 30%
Mine buildings and equipment	20%

Depletion of oil and gas properties and drilling costs is determined by the unit-of-production method based on proven reserves.

(f) Investments

The investment in shares of Discovery Mines Limited and Pyx Explorations Ltd., significantly influenced companies, are carried at cost adjusted by the company's share of the earnings or losses since significant influence was acquired.

Other long-term investments are written down when there is evidence that their inherent worth has declined below their carried value.

RAYROCK RESOURCES LIMITED

2. Investments and advances

(a) This item comprises:	1978 \$	1977 \$
Shares —		
Investment in shares of Discovery Mines Limited (49.1% owned) and Pyx Explorations Ltd. (25.4% owned) accounted for by the equity method (quoted market value 1978 — \$1,868,398; 1977 — \$901,680) (note 2(c))	1,194,358	826,272
Other quoted shares — at cost (quoted market value 1978 — \$869,853; 1977 — \$1,148,230)	1,025,923	1,425,880
Other shares (unlisted or escrowed) and debentures — at cost, less amounts written off	99,627	150,335
	<u>2,319,908</u>	<u>2,402,487</u>
Advances —		
Discovery Mines Limited	194,074	148,998
Amounts due from officers and employees	108,800	96,500
Less: Current portion (included in accounts receivable)	(9,500)	(10,800)
Other	—	46,039
	<u>293,374</u>	<u>280,737</u>
	<u>2,613,282</u>	<u>2,683,224</u>

(b) The quoted market values referred to above do not necessarily represent the realizable value of these holdings which may be more or less than that indicated by market quotation.

(c) In 1977, the company owned 314,248 shares of Pyx Explorations Ltd. (Pyx) which were included in other quoted shares at a cost of \$243,085.

During the year, the company purchased an additional 315,539 shares for cash of \$121,158, increasing its interest in that company to 25.4%.

The total cost of the company's investment exceeded the applicable portion of the underlying net book value of Pyx by approximately \$236,000. All of this excess is attributable to the value of an ore body in which a subsidiary of Pyx has a net profits interest. This excess will be written off by the unit of production method based on proven reserves.

3. Security for bank loans

The company's interests in certain producing natural gas properties are pledged as security for the bank indebtedness.

4. Capital stock and contributed surplus

(a) During the year the company purchased 19,100 of its own shares at a cost of \$32,064 (1977 — 12,000 shares for \$9,810). The company also disposed of 41,100 of its own shares for proceeds of \$49,263 (1977 — 12,176) which exceeded cost by \$14,756. This excess was credited to contributed surplus.

(b) During the year the company converted its authorized and issued capital from shares of a par value of \$1.00 each into shares of no par value.

(c) Incentive stock options for 75,000 shares were outstanding at December 31, 1978, exercisable at a price of \$0.90 to \$1.23 per share. The options have various expiry dates extending to December 31, 1983.

During the year the company issued 50,000 treasury shares for \$46,200 and 25,000 purchased shares for \$22,900 to employees exercising their stock options (1977 — nil). The 25,000 shares are included in the 41,100 shares referred to in note 4 (a) above.

5. Extraordinary items

	1978 \$	1977 \$
Write-off of balance due from Avoca Mines Limited	26,039	—
Share of mine shut-down expenses, net of gains or losses on sale of fixed assets of Icon Sullivan Joint Venture	3,432	12,906
Proportion, on an equity basis, of other extraordinary items reported by Discovery Mines Limited	45,711	—
	<u>75,182</u>	<u>12,906</u>

RAYROCK RESOURCES LIMITED

6. Adjustment of prior years' investment income

During 1976 and 1977, the company received dividends in the amount of \$9,588 and \$91,465 respectively, from an investment accounted for by the cost method. These dividends, which were originally recorded as investment income in error, were actually a return of invested capital and should have been applied to reduce the cost of the shares. Accordingly, the balances of retained earnings as at December 31, 1976 and 1977, previously reported as \$470,351 and \$735,695 respectively, have been restated.

7. Remuneration to directors and senior officers

- (a) Directors and senior officers, as defined in the Business Corporations Act (Ontario) including the five highest paid employees, received direct remuneration in the year ended December 31, 1978 of \$193,927 (1977 — \$176,447).
- (b) The company pays substantially all the remuneration of directors and senior officers, as defined in the Business Corporations Act (Ontario) of certain associated companies and is reimbursed by these companies for their proportionate share thereof.

8. Income taxes

The wholly-owned U.S. subsidiary has substantial loss carry-forwards for U.S. income tax purposes which expire in varying amounts over the next several years.

9. Contingent liabilities

The company is one of the defendants in a \$2,000,000 lawsuit which was commenced in the Superior Court of Quebec by certain Cree Indian bands in northwest Quebec relating to an alleged environmental problem, arising out of a joint venture operation in which the company has a 23.75% interest. The other defendants are Kerr Addison Mines Limited, Newmont Exploration of Canada Limited and Gunnex Limited. In the opinion of legal counsel for the company, it is not possible to predict the outcome of this action.

10. Reclassification

Certain figures in the 1977 financial statements have been reclassified to conform to the presentation adopted in 1978.

AUDITORS' REPORT TO THE SHAREHOLDERS

We have examined the consolidated balance sheet of Rayrock Resources Limited as at December 31, 1978 and the consolidated statements of earnings and retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1978 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Toronto, Canada
MARCH 15, 1979

COOPERS & LYBRAND
Chartered Accountants

